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525636—43

In the Supreme Court of the United States

OCTOBER TERM, 1942

No. 930

JOHN V. DOBSON, PETITIONER

v.

GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE

No. 931

E. W. DOBSON, PETITIONER

v.

GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE

No. 932

ESTATE OF JAMES N. COLLINS, DECEASED, FIRST NATIONAL BANK AND TRUST COMPANY OF MINNEAPOLIS, EXECUTOR PETITIONER

v.

GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE

No. 933

H. J. HARWICK, PETITIONER

v.

GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE

ON PETITION FOR WRITS OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE EIGHTH CIRCUIT

BRIEF FOR THE RESPONDENT IN OPPOSITION

OPINIONS BELOW

The opinion of the Board of Tax Appeals (R. 62–67) in *John V. Dobson* v. *Commissioner* is reported in 46 B. T. A. 770, and its opinion (R. 15–20) in *Estate of James N. Collins* v. *Commissioner* is reported in 46 B. T. A. 765. The memorandum opinions of the Board in *E. W. Dobson* v. *Commissioner* (R. 40–43) and in *Harwick* v. *Commissioner* (Harwick R. 10–14) are not officially reported.

The opinion of the Circuit Court of Appeals (R. 3–14) [1] is reported in 133 F. (2d) 732.

JURISDICTION

The judgments of the Circuit Court of Appeals were entered on March 2, 1943 (R. 15–18). The petition for writs of certiorari was filed April 15, 1943. The jurisdiction of this Court is invoked under Section 240 (a) of the Judicial Code, as amended by the Act of February 13, 1925.

QUESTIONS PRESENTED

1. Whether sums recovered in settlement of actions to rescind purchases of stock constitute taxable income to the extent that losses taken upon sales of the stock in prior tax years did not exceed the taxpayers' net losses for those years.

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[1] It should be noted that the transcript of proceedings in the Circuit Court of Appeals begins with page 1 rather than page 83 as it should if continuous with the rest of the record. The Harwick record is also paged separately and it will be referred to as the Harwick record, to prevent confusion.

2. Whether (in the Harwick case) such sums recovered upon assertion of a claim constitute taxable income where net income was reported in the earlier year after deduction of the losses, but because of the availability of credits against net income there would have been no tax liability even without the deduction.

3. Whether the sums recovered, if taxable, constitute ordinary income or gains from the "sale or exchange of a capital asset" within the meaning of Section 117 (a) (4) of the Internal Revenue Code.

STATUTE INVOLVED

Internal Revenue Code:

> SEC. 22. GROSS INCOME.
>
> (a) *General Definition.*—"Gross income" includes gains, profits, and income derived from salaries, wages, or compensation for personal service, of whatever kind and in whatever form paid, or from professions, vocations, trades, businesses, commerce, or sales, or dealings in property, whether real or personal, growing out of the ownership or use of or interest in such property; also from interest, rent, dividends, securities, or the transaction of any business caried on for gain or profit, or gains or profits and income derived from any source whatever. * * * (U. S. C. Title 26, Sec. 22).

SEC. 23. DEDUCTIONS FROM INCOME.

In computing net income there shall be allowed as deductions:

* * * * *

(e) *Losses by Individuals.*—In the case of an individual, losses sustained during the taxable year and not compensated for by insurance or otherwise—

* * * * *

(2) if incurred in any transaction entered into for profit, though not connected with trade or business;

* * * * *

(U. S. C., Title 26, Sec. 23.)

SEC. 117. CAPITAL GAINS AND LOSSES.

(a) *Definitions.*—As used in this chapter—

(1) *Capital Assets.*—The term "capital assets" means property held by the taxpayer (whether or not connected with his trade or business), * * *

* * * * *

(4) *Long-term capital gain.*—The term "long-term capital gain" means gain from the sale or exchange of a capital asset held for more than 18 months, if and to the extent such gain is taken into account in computing net income;

* * * * *

(U. S. C., Title 26, Sec. 117.)

STATEMENT

The stipulated facts (R. 21–25, 44–47, 74–79, and Harwick R. 20–24) in each of the cases were

adopted by the Board as its findings of fact (R. 15–17, 40–42, 63–65, and Harwick R. 10–14). They may be summarized as follows:

Several years before the taxable year 1939, the four taxpayers, all residents of Minnesota, had individually purchased stock of the National City Company of New York. Each had sold a portion or all of the stock at losses which were deducted on his income tax returns. (R. 16, 40, 63.)

E. W. Dobson, upon the sale of 200 shares in 1930, deducted a loss of $49,302.56 on his 1930 return. The return showed a net loss (after all deductions) of $30,197.56. (R. 40, 46.) John V. Dobson, upon his sale of 200 shares in that year, deducted $62,271 on his 1930 return. The return showed a net loss (after all deductions) of $30,043.47. (R. 63–65.) Collins[2] sold 100 shares in 1930 and 1931, respectively, taking a loss of $41,600.80 for 1930 and a loss of $28,163.78 for 1931. He had net losses (after all deductions) of $65,896.51 for 1930 and $40,204.90 for 1931. (R. 16, 23, 24.) Harwick sold 100 shares in 1931 and deducted a loss of $34,451.28 for that year. He reported a net income of $12,042.03, but his return indicated that, due to certain credits, he owed no tax. (Harwick R. 11–12.)

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[2] Collins died on April 21, 1941, before his case was heard by the Board of Tax Appeals; his executor was substituted as petitioner, but for convenience Collins will be referred to here as the taxpayer (R. 15).

At first, each of these taxpayers considered their purchases and sales of this stock as closed and completed transactions; but several years later they learned that the stock of the National City Company had not been registered in accordance with the requirements of the Minnesota Blue Sky laws. Accordingly, Harwick asserted a claim against the National City Company and the other taxpayers filed suits against that company, each contending (1) that the stock had been sold to them without having been registered as required by state law, and (2) that the sales had been fraudulent. In the complaints filed in the three suits, a request was made for a rescission of the sale contracts and there was an offer to turn over the proceeds of the stock sales, or an equal number of shares plus income thereon. (R. 16, 41, 64, and Harwick R. 11.)

The three suits and Harwick's claim were settled in 1939 (R. 16, 41, 64; Harwick R. 11). E. W. Dobson received $31,432.80 allocable to the stock sold in 1930 (R. 41–42); John V. Dobson received $32,294.96 allocable to his stock sold in 1930 (R. 64–65); Collins received $23,296.45 allocable to the stock sold in 1930 and $6,454.18 allocable to the stock sold in 1931 (R. 16–17). Harwick received $17,000 (Harwick, R. 11). In all four cases the original purchase prices of the stocks exceeded the sums received on the sales in 1930 plus the recoveries in 1939.

Neither E. W. Dobson, John V. Dobson, nor Collins reported any of these recoveries as income for 1939 (R. 41–42, 64–65, 16–17). Harwick reported $9,884.22, conceding that he had recovered a tax benefit in that amount from the deduction in 1931 (Harwick, R. 11). Throughout the year 1939 adjustment of the liabilities for 1930 and 1931 was barred by the statute of limitations (R. 17, 42, 65; Harwick, R. 11).

The Commissioner returned the entire amounts of the recoveries to income. The Board held that they were subject to tax to the extent that the prior deductions had offset gross income. Accordingly, since E. W. Dobson's and Collins' net losses had exceeded their deductions, the Board reversed the Commissioner in these cases (R. 18–20, 43). In the case of John V. Dobson, the Board held that the recovery was taxable to the extent that the 1939 recovery exceeded the net loss for 1930 (R. 65–67). In the case of Harwick, the Board held that since he reported net income after all deductions in 1931, the loss deduction in that year had resulted in a tax benefit, and therefore the entire amount recovered in 1939 should be included in his gross income (Harwick, R. 13–14). The Board further held in these latter two cases that the income was taxable as ordinary gain (R. 66; Harwick, R. 14).

The Circuit Court of Appeals sustained the Board in the Harwick case, and reversed in the

other three, holding that in each case the entire recovery was taxable as ordinary gain whether or not the prior deductions had resulted in a tax benefit (R. 15–18).

DISCUSSION

1. The decision below is in accord with the decisions of the Circuit Courts of Appeals for the Third and Fourth Circuits holding that recoveries of debts, previously charged off as worthless, constitute taxable income, whether or not the prior deductions resulted in a tax benefit. *Helvering* v. *State-Planters Bank & Trust Co.*, 130 F. 2d 44 (C. C. A. 4th); *Commissioner* v. *United States & Int. Sec. Corp.*, 130 F. 2d 894 (C. C. A. 3d).[3] These decisions are consistent with the principles enunciated in *Burnet* v. *Sanford & Brooks Co.*, 282 U. S. 359, 365, and *United States* v. *Ludey*, 274 U. S. 295. Recognition of the loss realized upon sale of the stock in the prior years assumes complete disposition of the capital asset for tax purposes. Consequently, any recovery in a future year is not a return of capital but is necessarily income within that year.

An analogous problem is now pending before this Court in *Virginian Hotel Corporation of Lynchburg* v. *Helvering*, No. 766. In that case, the

[3] The court has granted a rehearing in this case to determine the effect of Section 116 of the Revenue Act of 1942, Public Law 753, 77th Cong., 2d Sess. This statute does not touch the instant problem.

Fourth Circuit held that in computing the adjusted basis of property for depreciation purposes, excessive depreciation taken in prior years should be deducted from the taxpayers' cost basis as depreciation "allowed" within the meaning of Section 113 (b) (1) (B) of the Revenue Act of 1938, although it did not offset taxable income. The Government opposed certiorari in that case on the ground that although there was a conflict with *Pittsburgh Brewing Co.* v. *Commissioner,* 107 F. 2d 155 (C. C. A. 3d), that case was no longer authoritative in view of the Third Circuit's later decision in *Commissioner* v. *United States & Int. Sec. Corp., supra;* hence, we suggested that in the absence of a present conflict, this Court would be justified in denying the petition. As the Court granted certiorari in No. 766, apparently it was of the view that the two Third Circuit cases involved problems which were distinguishable. The problem in the instant case is essentially the same as that in the bad debt recovery cases, and therefore it would appear that the pendency of the *Virginian Hotel* case does not warrant certiorari here.

2. The second question, raised by the *Harwick case,* presents the problem of what constitutes a "tax benefit" if that is essential. There is no occasion for the Court's consideration of this point unless certiorari should be granted to review the basic issue.

3. The contention that the recoveries in settlement of the taxpayers' claims constituted "capital

gain" within the meaning of Section 117 (a) (4) of the Code is plainly without merit. Certainly, the recoveries did not constitute a "sale or exchange" of capital assets within the ordinary meaning of these terms. Cf. *Helvering* v. *Flaccus Leather Co.*, 313 U. S. 247. Consequently, even if the Court should grant the taxpayers' petition on the first two issues, we submit that review of the third issue is unnecessary.

CONCLUSION

The petition for certiorari should be denied.

Respectfully submitted.

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